

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>TWO KINGS, INC.</b>	:	DETERMINATION DTA NO. 819214
for Redetermination of Deficiencies or for Refund of New York State and New York City Income Taxes under Article 22 of the Tax Law and the New York City Administrative Code for the Period January 14, 1994 through December 25, 1998.	:	

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Petitioner, Two Kings, Inc., 3235 Grand Concourse, Bronx, New York 10468, filed a petition for redetermination of deficiencies or for refund of New York State and New York City income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the period January 14, 1994 through December 25, 1998.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 21, 2003 at 10:30 A.M., with all briefs to be submitted by January 19, 2004, which date began the six-month period for the issuance of this determination. Petitioner appeared by Lionel Lewis, C.P.A. The Division of Taxation appeared by Mark F. Volk, Esq. ( Peter B. Ostwald, Esq., of counsel).

***ISSUE***

Whether the Division of Taxation properly assessed Two Kings, Inc., for New York State and New York City withholding taxes for the period January 14, 1994 through December 25, 1998.

***FINDINGS OF FACT***

1. Petitioner, Two Kings, Inc. (“Two Kings”), was a New York City real estate management company which was operated by its sole shareholder and president, Rexh Xhakli.

2. Following a field audit of petitioner, the Division of Taxation (“Division”) issued to petitioner ten notices of deficiency, dated January 29, 2001, as more specifically set forth in the table below.

<b>Tax Period and (Article)</b>	<b>Tax Assessed</b>	<b>Interest</b>	<b>Penalty</b>	<b>Total Due</b>
1994 (22)	\$79,538.94	\$60,086.99	\$83,900.26	\$223,526.19
1994 (30)	4,637.10	3,503.07	32,112.34	40,252.51
1995 (22)	77,988.04	47,418.83	73,106.06	198,512.93
1995 (30)	4,622.02	2,810.34	30,236.33	37,668.69
1996 (22)	72,348.12	34,106.81	64,757.92	171,212.85
1996 (30)	4,691.96	2,211.90	29,940.44	36,844.30
1997 (22)	69,585.10	24,100.73	58,926.05	152,611.88
1997 (30)	4,741.10	1,642.07	29,658.19	36,041.36
1998 (22)	69,981.08	16,405.40	55,197.18	141,583.66
1998 (30)	5,096.00	1,194.60	29,452.07	35,742.67

3. Petitioner was notified by letter dated May 20, 1999 that its New York State and New York City withholding tax returns for the period January 1, 1992<sup>1</sup> through December 31, 1998 (the “audit period”) had been selected for a field audit. An appointment was scheduled for June 21, 1999 at petitioner’s address, at which time petitioner was asked to have available for the period January 1, 1992 through December 31, 1998 all payroll records, Federal and State payroll

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<sup>1</sup>This date was subsequently changed to January 14, 1994.

tax returns for the audit period, including forms W-2, IT-2102, forms W-3, W-4, IT-2104, 1099 and 941, the Employer's Quarterly Tax Return and Quarterly Combined Withholding and Wage Reporting Returns. After a postponement, the field visit took place on July 20, 1999, at which time petitioner produced only check registers for the years 1994 and 1995. A search of the Division's records revealed that petitioner had not filed any withholding tax returns for the audit period.

4. On July 23, 1999, the Division made an additional request for records, seeking Federal and New York corporate tax returns, general ledgers and disbursement journals. An office conference was scheduled for August 22, 1999 for the production of these records, but it was canceled by petitioner. In response, the Division issued a subpoena for petitioner's records, but once again petitioner submitted no records.

5. The Division analyzed its transcript of the checks produced by petitioner at the field visit on July 20, 1999 and questioned whether the underlying expenses for which some of the checks were issued were incurred on behalf of petitioner or Mr. Xhakli. With no evidence presented to demonstrate that the checks represented bona fide expenses of petitioner, it was assumed that they were issued to, or on behalf of, Mr. Xhakli and that the sum of the checks, \$920,257.12, was considered wages paid by petitioner to him in 1994. This wage figure was used to calculate petitioner's New York State withholding tax due in the amount of \$79,538.94 and New York City withholding tax due in the amount of \$4,637.10. Lacking any further documentation, the Division used the same wage estimates from 1994 to calculate the withholding tax due from petitioner for the years 1995 through 1998.

6. After the Division issued a statement of proposed audit changes on September 5, 2000, a conference was held on September 14, 2000 at which petitioner submitted the following

documents: partnership returns for the predecessor entity, Two Kings Associates, for the years 1992 and 1994; Federal form 1120 for the years 1994 through 1998; and New York form CT-3 for the years 1994 and 1995. Although these comprised some of the documents the Division sought in its subpoena, they did not substantiate petitioner's claim that checks drawn on the corporate bank account, upon which the assessment was based, were not wages paid to its president, Mr. Xhakli.

7. Subsequent to the September 14, 2000 meeting, petitioner submitted various documents to demonstrate that moneys paid to Mr. Xhakli were not wages upon which petitioner owed withholding taxes. Included in this submission were: a deposit slip, dated 1989, indicating a deposit made to Mr. Xhakli's personal account, and a statement for that account, dated November/December 1989; a brokerage account statement for Mr. Xhakli, dated May/June, 1994; closing documents for 272 Gun Hill Road, Bronx, NY and 3235 Bainbridge Avenue, Bronx, NY; a list of capital improvements made to 3052-54 Kingsbridge Avenue and 3235 Grand Concourse, Bronx, NY; a mortgage closing statement for petitioner, dated 1994; the 1994 rental receipts register for Two Kings Associates; and a filing receipt indicating the incorporation of Two Kings, Inc. After reviewing the documentation, the Division concluded that petitioner had not demonstrated that the deposits and transfers were made to, or on behalf of, Two Kings, Inc., and no modification was made to the statement of proposed audit changes.

8. Petitioner offered into evidence at hearing several documents to substantiate its claim that the funds found by the Division on audit were not wages to Mr. Xhakli but legitimate business expenses. Included in this offering was a summary statement of expenses paid to Jackly Construction & Renovation Co. for materials and labor expended on projects at the

properties owned by petitioner for the years 1987 through 2001. This list, prepared by petitioner, was supplemented by contracts between petitioner and Jackly for specific job proposals.

In addition, petitioner submitted one monthly bank statement of Two Kings Associates from Citibank, N.A., for the period April 23, 1994 through May 10, 1994 and 39 copies of checks drawn on the same account, only 6 of which were reflected on the statement. Of these six checks, all of which were issued prior to April 15, 1994, none had a substantiated purpose related to petitioner's business operations and no explanation was offered to demonstrate otherwise.<sup>2</sup> The statement also reflects a deposit on May 6, 1994 of \$250,000.00 which was never explained.

9. Two Kings, Inc. was incorporated on April 15, 1994 as reflected in the Application for Employer Identification Number. The Division was aware of this date, which it noted in the audit file's DO 220.5, or audit log. Thereafter, petitioner received by quitclaim deed, dated April 25, 1994, certain real property owned by Mr. Xhakli and known as 3052-3054 Kingsbridge Road, Bronx, New York. On the same date, petitioner received a mortgage loan in the sum of \$950,000.00 from the First Federal Savings and Loan Association of Rochester, \$552,379.02 of which was paid directly to petitioner. However, petitioner submitted no documentation to establish receipt or application of these funds.

10. Petitioner submitted into evidence various miscellaneous documentation which included the following: 1992 U.S. Partnership Return for Two Kings Associates; 1996 and 1997 U.S. corporation income tax returns filed for petitioner; Mr. Xhakli's 1992 New York State Resident Income Tax Return and 1998 Nonresident Income Tax Return; and a March 13, 1992

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<sup>2</sup>The six checks from Citibank were check numbers 4603, 4638, 4602, 4601, 4599 and 4588. They appear on the bank statement submitted into evidence by petitioner and also on the Division's transcript of check registers.

notarized letter from Mr. Xhakli to Mihane Mehmeti, reciting a loan from Mihane Mehmeti to Mr. Xhakli in the sum of \$150,000.00 payable in “3-4 months” with copies of two bank checks payable to Shpresa Idrizi in the sums of \$65,000.00 and \$85,000.00. No supporting documentation was offered for any of the above submissions. Mr. Xhakli testified that he placed corporate funds in his own account for safekeeping and acknowledged that alimony, doctor bills and other personal expenses were written on the Two Kings Associates Citibank account.<sup>3</sup>

### ***CONCLUSIONS OF LAW***

A. Tax Law § 671(a)(1) requires every employer maintaining an office or transacting business in New York and making payment of any taxable wages to a resident or nonresident to deduct and withhold from such wages for each payroll period a tax in an amount substantially equal to the tax reasonably estimated to be due from the employee's New York adjusted gross income or New York source income received during the calendar year. Sections 11-1771 and 11-1908 of the New York City Administrative Code impose a similar obligation on employers with respect to the collection of New York City withholding tax. The method of determining the amount to be withheld is prescribed by regulations issued by the Commissioner (*see*, 20 NYCRR part 171).

B. Section 675 of the Tax Law provides that every employer required to deduct and withhold tax under Article 22 is liable for such tax. Sections 11-1775 and 11-1913 of the New York City Administrative Code contain parallel provisions pertaining to the employer's liability for New York City withholding tax.

C. Tax Law § 681(a) provides that, if a taxpayer fails to file a return required under

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<sup>3</sup>From the evidence in the record, it is apparent that this account remained open and active after the date of petitioner's incorporation.

Article 22, the Division is authorized to estimate a taxpayer's New York taxable income and the tax thereon, from any information in its possession and mail a notice of deficiency to the taxpayer. Although such a notice must have a rational basis, it is presumed correct, and the Division is not required to affirmatively demonstrate the propriety of its assessment (*see, Matter of Tapolacci v. State Tax Commn.*, 77 AD2d 759, 431 NYS2d 174; *Matter of Atlantic & Hudson Ltd. Partnership*, Tax Appeals Tribunal, January 30, 1992).

In *Matter of R & J Automotive* (Tax Appeals Tribunal, June 15, 1989), the Tribunal stated:

The standard articulated by the courts of New York concerning audits of personal income is that indirect auditing methods are proper where the taxpayer's income is not accurately reflected in the books and records (citations omitted).

Therefore, once the Division has determined petitioner's tax liability, the taxpayer bears the "burden of proving by clear and convincing evidence that the deficiency assessment and the method used to arrive at the assessment were erroneous" (*Leogrande v. Tax Appeals Tribunal*, 187 AD2d 768, 589 NYS2d 383, 384, *lv denied* 81 NY2d 704, 595 NYS2d 398; *see also*, Tax Law § 689[e]).

D. In this case, although not required to do so, the Division made several requests for records, including a subpoena, subsequent to which it received business records which were completely inadequate for the purpose of determining the amount of withholding tax due. Therefore, the Division's use of the check registers provided by petitioner at the field visit was reasonable and provided a rational basis for the tax, interest and penalties assessed on the ten notices of deficiency. (Tax Law § 681[a].) Its assumption that the checks were issued to or for the benefit of petitioner's president, Mr. Xhakli, was sound, given petitioner's failure to offer any evidence that the checks were issued for legitimate business purposes.

E. To meet its burden of proving that the assessments were erroneous petitioner offered many documents which are more fully set forth in Findings of Fact “6”, “7”, “8” and “10”. However, most of these documents pertained to years before and after the audit period and almost none were probative of the issue of whether the checks listed on the registers provided to the Division were legitimate business expenses or funds paid to or on behalf of Mr. Khakli as wages.

Petitioner’s unfortunate circumstances stem from its own actions and those of Mr. Khakli. There was no clear demarcation between petitioner and Two Kings Associates, which had previously managed the property at 3052-3054 Kingsbridge Road, Bronx, New York, including the obvious use of the partnership’s bank account with Citibank for the corporation after the corporation’s incorporation on April 15, 1994. In addition, Mr. Khakli, by his own admission under oath, commingled petitioner’s funds with his own, disregarding the corporate entity and making it impossible to distinguish for whose benefit checks were issued. For these reasons, petitioner has failed to carry its burden of proof. (Tax Law § 689[e].)

F. Although the Division’s assessment was sound, there are modifications which must be made given the evidence presented to it during audit and at the formal hearing. First, since the Division was aware of petitioner’s date of incorporation, April 15, 1994, any assessment issued to petitioner for periods or partial periods prior to this date must be canceled, since by definition there was no entity to assess. Further, petitioner submitted copies of six checks, more fully described in Finding of Fact “8”, which can be traced directly to the Citibank bank statement it submitted and the transcript prepared by the Division on field audit. Those checks were used to establish the wages paid to Mr. Khakli in 1994, even though all of them are dated prior to petitioner’s date of incorporation. The Division is directed to recompute the wage figure for



1994 without those checks and recalculate the tax, penalty and interest due for all periods in the audit period.

G. The petition of Two Kings, Inc. is granted to the extent set forth in Conclusion of Law “F” above and the Division is directed to make the modifications to the notices of deficiency consistent therewith, but in all other respects the petition is denied; the Division’s ten notices of deficiency, dated January 29, 2001, as modified, are sustained.

DATED: Troy, New York  
June 3, 2004

/s/ Joseph W. Pinto, Jr.  
ADMINISTRATIVE LAW JUDGE